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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

PENNSYLVANIA POWER COMPANY,
Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION and
PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE,
Respondents

Petition for a Writ of Certiorari to the Supreme Court of Pennsylvania

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether, under this Court's decisions in *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), a state public utility commission may refuse to allow an electric utility to recover, in retail rates, the cost of power that has been allocated to the utility under an interstate agreement and that has been purchased by the utility pursuant to that agreement at rates filed with and approved by the Federal Energy Regulatory Commission.

LIST OF INTERESTED PARTIES

The names of all parties who appeared in the Supreme Court of Pennsylvania are set forth in the caption. Ohio Edison Company is the parent of petitioner Pennsylvania Power Company. Petitioner has no subsidiaries that are not wholly owned.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
LIST OF INTERESTED PARTIES	ii
TABLE OF AUTHORITIES	v
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT OF THE CASE	2
REASONS FOR GRANTING THE PETITION	8
A. THE LOWER COURT'S RULING ON FEDERAL PREEMPTION CONFLICTS WITH THE DECISIONS OF THIS COURT	9
1. Federal Preemption And The Filed Rate Doctrine	9
2. Federal Preemption Of The PUC's Decision	12
B. THE COURT MAY WISH TO HOLD THIS PETITION PENDING A RESOLUTION OF *NEW ORLEANS PUBLIC SERVICE INC. v. COUNCIL OF THE CITY OF NEW ORLEANS*	20
CONCLUSION	23
APPENDIX A	
Judgment Order of the Supreme Court of Pennsylvania	1a
APPENDIX B	
Order and Opinion of the Commonwealth Court of Pennsylvania	2a

TABLE OF CONTENTS—Continued

APPENDIX C — Page

Order and Opinion of the Pennsylvania Public Utility Commission 24a

APPENDIX D

Excerpts from the United States Constitution and the Federal Power Act 36a

APPENDIX E

July 29, 1988 Order of the Federal Energy Regulatory Commission 47a

APPENDIX F

Excerpt from Petition for a Writ of Certiorari in *New Orleans Public Service Inc. v. Council Of The City Of New Orleans*, No. 90-1156 (cert. granted April 22, 1991) 53a

TABLE OF AUTHORITIES

CASES — Page

Allegheny Ludlum Steel Corp. v. Pennsylvania Public Utility Commission, 501 Pa. 71, 459 A.2d 1218 (1983) 5
Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375 (1983) 9
Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571 (1981) 12
Chicago and North Western Transp. Co. v. Kalo Brick & Tile, 450 U.S. 311 (1981) 12
In re Cleveland Electric Illuminating Co., 44 F.E.R.C. ¶ 61,179 (1988) 4, 5
In re Cleveland Electric Illuminating Co., 47 F.E.R.C. ¶ 61,127 (1989) 5
Federal Power Commission v. Southern California Edison Co., 376 U.S. 205 (1964) 20
International Paper Company v. Ouellette, 479 U.S. 488 (1987) 9
Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988) ..... *passim*
Montana-Dakota Utilities Co. v. Northwestern Public Service Co., 341 U.S. 246 (1951) 10, 12
Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986) ..... *passim*
New Orleans Public Service Inc. v. Council Of The City Of New Orleans, 911 F.2d 993 (5th Cir. 1990), *cert. granted*, 111 S. Ct. 1617 (1991) 21
Northern Natural Gas Co. v. State Corporation Commission of Kansas, 372 U.S. 84 (1963) 11
Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas, 489 U.S. 493 (1989) 9
Pike County Light & Power Co. v. Pennsylvania Public Utility Commission, 77 Pa. Commw. 268, 465 A.2d 735 (1983) 8, 18

CONSTITUTION, STATUTES AND REGULATIONS

U.S. Const. art. VI 10
Federal Power Act, 16 U.S.C. §§ 791a-828c 2
16 U.S.C. § 824 9
16 U.S.C. § 824d 4, 9, 10

TABLE OF AUTHORITIES—Continued

	Page
16 U.S.C. § 824e	9, 10
28 U.S.C. § 1257(a)	2
66 Pa.C.S. § 1307	5
18 C.F.R. § 35.1	4
MISCELLANEOUS	
52 Fed. Reg. 46,825 (Dec. 10, 1987)	4
Amicus Curiae Brief of FERC Supporting Petitioner, No. 90-1156	22
Petition for a Writ of Certiorari in *New Orleans Public Service Inc. v. Council Of The City Of New Orleans*, No. 90-1156	20

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Pennsylvania Power Company ("Penn Power") respectfully petitions for a writ of certiorari to review the judgment of the Supreme Court of Pennsylvania in this case.

OPINIONS BELOW

The Judgment Order of the Supreme Court of Pennsylvania, App. 1a, is reported at 587 A.2d 312. The Order and Opinion of the Commonwealth Court of Pennsylvania, App. 2a-23a, is reported at 561 A.2d 43. The Order and Opinion of the Pennsylvania Public Utility Commission, App. 24a-35a, is reported at 93 PUR 4th 359.

JURISDICTION

The judgment of the Supreme Court of Pennsylvania was entered on March 21, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant provisions of the United States Constitution and of the Federal Power Act, 16 U.S.C. §§ 791a-828c, are reprinted at App. 36a-46a.

STATEMENT OF THE CASE

The question in this case is whether the federal regulatory scheme that governs interstate sales of electric power preempts a state utility commission from assessing the reasonableness of agreements that affect the wholesale rates for that power. This issue is related to the one presented in *New Orleans Public Service Inc. v. Council Of The City Of New Orleans*, No. 90-1156 (cert. granted April 22, 1991), a case that will be argued in this Court next Term.

Penn Power is a public utility that provides residential and commercial electric service to parts of western Pennsylvania. In addition to maintaining its own operations, Penn Power is one of several public utilities that belongs to the Central Area Power Coordination Group ("CAPCO"), an integrated power pool whose main purpose is to achieve economies of scale in the construction, financing, and operation of electric generating facilities.[1] The relation-

[1] At the times relevant to this petition, the other members of CAPCO were Ohio Edison Company, Duquesne Light Company, Cleveland Electric Illuminating Company, and Toledo Edison Company.

ship among the members is governed by the CAPCO Basic Operating Agreement.

In the early 1970s, the CAPCO companies agreed to construct a nuclear electric generating unit known as Perry Unit No. 1 ("Perry 1") on the southern shore of Lake Erie, in Ohio. They also agreed how the capacity from Perry 1 was to be allocated; it was agreed, for example, that Penn Power's share would be 75 megawatts ("MW"). In January 1980, however, before the construction of Perry 1 was complete, changed economic circumstances led Penn Power and another CAPCO member, Cleveland Electric Illuminating Company ("Cleveland Electric"), to enter into a revised agreement that reallocated some of the Perry 1 capacity. Under the new agreement, Penn Power sold 12 MW of its original allocation to Cleveland Electric, thereby reducing Penn Power's share of Perry 1 from 75 MW to 63 MW.

One of the terms of this reallocation agreement was that Penn Power would "buy back" the 12 MW from Cleveland Electric for a short period of time. This requirement, known as the "Perry 1 buyback," was to begin on the day Perry 1 achieved commercial operation, and was to last 18 months. The agreement also provided that the costs, *i.e.*, the rates, to be paid by Penn Power to Cleveland Electric for the Perry 1 buyback were to be set pursuant to the CAPCO Basic Operating Agreement.[2]

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[2] The agreement between Penn Power and Cleveland Electric also involved CAPCO member Ohio Edison, which is Penn Power's parent company. In addition to Penn Power's 12 MW transaction, Ohio Edison agreed to sell and then buy back from Cleveland Electric 68 MW of its own allocation of Perry 1 power. Because Penn Power and Ohio Edison are in some instances treated as a single party for CAPCO purposes, the

Perry 1 achieved commercial operation on November 18, 1987. On December 2, 1987, the CAPCO companies filed with the Federal Energy Regulatory Commission ("FERC") Appendix 7 to Schedule E of the CAPCO Basic Operating Agreement.[3] Among other things, Appendix 7 sets forth in detail the basis for determining the cost of capacity and energy sales from Perry 1. Appendix 7 also sets forth Perry 1's generating capacity, including Penn Power's 63 MW share of that capacity. Public notice of the filing appeared in the Federal Register, stating that "[a]ny person desiring to be heard or to protest said filing should file a motion to intervene or protest with [FERC]." 52 Fed. Reg. 46,825 (Dec. 10, 1987). No party intervened or challenged this filing before FERC.

In an Order dated July 29, 1988, FERC formally accepted Appendix 7 for filing, thereby making the rates set forth in Appendix 7 effective, subject to further investigation and certain conditions not relevant here.[4] *See In re Cleveland Electric Illuminating*

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entire sale and buyback from Cleveland Electric is sometimes referred to as an "80 MW" sale (68 MW + 12 MW). *See, e.g.*, App. 50a.

[3] Both the CAPCO Basic Operating Agreement and Appendix 7 were required to be filed under the Federal Power Act and accompanying regulations. The Act provides that a public utility is required to file with FERC "all rates and charges" for any transmission or sale that is subject to FERC's jurisdiction, as well as the "classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services." *See* 16 U.S.C. § 824d(c), App. 39a. *See also* 18 C.F.R. § 35.1(a).

[4] For example, in reviewing the filing FERC determined that Cleveland Electric was using an inappropriate amortiza-

Co., 44 F.E.R.C. ¶ 61,179 (1988); App. 47a-52a. In the Order, FERC specifically noted that "[t]he filing submitted here is specific to the 80 MW Cleveland/Edison transaction."[5] *Id.*, App. 50a. After further negotiations between the parties and FERC, and the resolution of other issues, FERC concluded its investigation into the lawfulness of the Perry 1 buyback rates. *See In re Cleveland Electric Illuminating Co.*, 47 F.E.R.C. ¶ 61,127 (1989).

At the same time as Perry 1 achieved commercial operation, Penn Power filed an interim Energy Cost Rate ("ECR") with the Pennsylvania Public Utility Commission ("PUC").[6] One reason for the ECR filing was to allow Penn Power to begin to recover in its retail rates the costs associated with the Perry 1 buyback. The Pennsylvania Office of Consumer Advocate ("Consumer Advocate") and the PUC Trial Staff objected to the ECR, arguing, among other things, that Penn Power's temporary buyback of the 12 MW was unjustified, and that recovery of the resulting wholesale costs should therefore be disallowed.

The matter was first presented to an Administrative Law Judge, who concluded that it was unreasonable for Penn Power to have purchased this high-cost power. *See* App. 28a. The ALJ accordingly rec-

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tion period for the recovery of the decommissioning charges for the Perry 1 unit. App. 49a.

[5] *See* note 2, *supra*. The Commission therefore was recognizing in its Order that the rates in Appendix 7 to Schedule E applied to the Perry 1 buyback.

[6] An ECR filing is a mechanism by which a utility may recover in its retail rates specific energy costs that are not covered by the utility's base rates. *See* 66 Pa.C.S. § 1307; *Allegheny Ludlum Steel Corp. v. Pennsylvania Public Utility Commission*, 501 Pa. 71, 75-76 n.3, 459 A.2d 1218, 1220 n.3 (1983).

ommended that most of Penn Power's costs associated with the buyback be disallowed. The matter was then presented to the PUC, where Penn Power argued, *inter alia*, that the earlier filing with FERC preempted the PUC's authority over this matter. *See* App. 28a.

The PUC rejected this preemption argument. In an Order and Opinion issued May 3, 1988, the PUC concluded that Penn Power had not shown a sufficient need for the 12 MW being purchased from Cleveland Electric, given that lower-cost power was then readily available from other sources.[7] App. 29a. This determination was not preempted, said the PUC, because FERC only reviewed the rate itself, not the utility's decision to buy power at that rate. Consequently, the PUC allowed Penn Power to recover in its retail rates only the amount that it *would* have paid had it purchased the 12 MW from a lower-priced source. App. 34a. The result was to disallow, or "trap," over $16 million (approximately 90%) of the costs Penn Power incurred under the Perry 1 buyback agreement and the FERC-filed rates that governed that agreement.[8]

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[7] The PUC's discussion of Penn Power's "need" for the 12 MW must be read in the context of the PUC's full decision. The issue of whether the 12 MW constituted excess capacity was raised in the proceedings below, and was specifically rejected by the PUC. App. 28a. The PUC accordingly allowed Penn Power to recover its costs of buying the 12 MW, albeit at a much lower price. Thus, the PUC's conclusion that Penn Power did not "need" this energy was simply another way of saying that, in the PUC's view, Penn Power did not need to buy the 12 MW *at that price*. *See* App. 29a.

[8] The PUC's conclusion that lower-cost power "is readily available" highlights the unfairness of using hindsight to evaluate Penn Power's conduct. The fact that cheaper power

On appeal to the Pennsylvania Commonwealth Court, Penn Power again argued that the PUC's authority had been preempted. Penn Power pointed out that it was obligated to pay the wholesale rates that were on file with FERC for the 12 MW, and that under *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), a state does not have jurisdiction to second-guess the reasonableness of those filed rates by denying a utility the right to recover its wholesale costs. Penn Power also argued that the PUC's decision was preempted under the holding and reasoning of *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), a decision that was announced shortly after the PUC issued its Order and Opinion.

The Commonwealth Court rejected the preemption argument and affirmed. Although the court agreed that the prior filing with FERC had foreclosed further examination of the wholesale rates Penn Power was required to pay, it concluded that there had been no such reexamination by the PUC here. Instead, said the court, the PUC had simply re-evaluated the wisdom of the decision to buy 12 MW of power from this particular source, and found that the purchase was unjustified in light of the current availability of lower-cost electricity. App. 19a-20a. Based on this purported distinction, and on its conclusion that the decision to buy back the 12 MW was not "mandated" by FERC, the Commonwealth Court ruled that the PUC's authority had not been preempted, and that

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may have been available in 1987 says nothing about the availability of such power in 1980, when Penn Power committed to buy the 12 MW, and ignores the overall fairness of the agreement between Cleveland Electric and Penn Power.

there was no conflict between its decision and the opinions in *Mississippi Power* and *Nantahala*. The governing case, in the view of the Commonwealth Court, was its own decision in *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission*, 77 Pa. Commw. 268, 465 A.2d 735 (1983). *See* App. 20a.

The Supreme Court of Pennsylvania granted Penn Power's petition for discretionary review, limited to the federal preemption issue. After briefing and oral argument, the Supreme Court of Pennsylvania affirmed the Commonwealth Court's decision by judgment order, with one Justice dissenting. App. 1a.

REASONS FOR GRANTING THE PETITION

The court below has attempted to carve out an exception to FERC's exclusive jurisdiction over transactions involving the interstate sale of electrical power. While recognizing the preemptive force of matters on file with FERC, the Commonwealth Court nevertheless has permitted the PUC to regulate sales of electric power in a manner that circumvents that preemptive effect. The decision below thus interferes with the proper workings of the federal regulatory scheme, by exposing public utilities to the precise conflict between state and federal requirements that the federal preemption doctrine is designed to prevent. Such a decision, which is contrary to the recent case law of this Court, should not be allowed to stand.

This Court has already granted certiorari in a case that raises a related issue. The question presented in *New Orleans Public Service Inc. v. Council of The City of New Orleans*, No. 90-1156 (cert. granted April 22, 1991) (*"NOPSI"*), will call on this Court

to address the preemptive scope of FERC's regulatory authority, as well as the states' authority to regulate agreements that affect wholesale power transactions. *See* App. 54a. Because the decision in *NOPSI* is likely to have an effect on the validity of the decision here, the Court may wish to hold this petition pending its disposition of *NOPSI*.

A. THE LOWER COURT'S RULING ON FEDERAL PREEMPTION CONFLICTS WITH THE DECISIONS OF THIS COURT

1. *Federal Preemption And The Filed Rate Doctrine.*

Congress has granted FERC the exclusive authority to regulate the sale of interstate electrical power, and to set the wholesale rates for that power. *See* 16 U.S.C. §§ 824, 824d, 824e, App. 37a-46a; *Mississippi Power*, 487 U.S. at 371. *Cf. Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375 (1983). The preemptive effect of that authority is far-reaching. Even where Congress has not expressly stated that federal regulation is to be the exclusive source of authority, a state's regulation will still be preempted if it "conflicts" with federal law. *See Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas*, 489 U.S. 493, 509 (1989). Such a conflict will be found either where it is impossible to comply with both federal and state law, or where the state regulation "stands as an obstacle to the accomplishment and execution of congressional objectives." *Id. See also International Paper Company v. Ouellette*, 479 U.S. 488, 591-92 (1987).

The preemptive effect of FERC's regulatory authority extends to matters presented to the Commission by private parties. This feature of FERC's authority, which derives from the Supremacy Clause,

U.S. Const. art. VI, cl. 2, App. 36a, is the source of the so-called "filed rate doctrine." *See Nantahala*, 476 U.S. at 962-63. Simply put, this doctrine precludes state courts and state utility commissions from second-guessing the reasonableness of rates on file with FERC. Under the Federal Power Act, utilities are required to file with FERC the rates they wish to charge for wholesale interstate sales of electricity. 16 U.S.C. § 824d(c), (d), App. 39a. FERC then has the exclusive authority to decide whether the proposed rates are "just and reasonable." *Id.* § 824e, App. 43a. By protecting filed rates from review and re-evaluation by the states, the filed rate doctrine ensures the primacy of federal regulation, and prevents state regulation from creating an obstacle to the accomplishment of congressional objectives. *See Mississippi Power*, 487 U.S. at 371-72; *Nantahala*, 476 U.S. at 962; *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951).

The practical justification for preempting state regulations that affect rates filed with FERC is to prevent the unfair "trapping" of a utility's wholesale costs. *See Mississippi Power*, 487 U.S. at 372 & n.12. Trapping occurs when a utility is required by its filing with FERC to pay a certain wholesale rate for energy, but then is prevented by a state from recovering the full amount of those costs in its retail rates. *See id.* As this Court has recognized:

> The filed rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates. . . . [A] State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from

> recovering the costs of paying the FERC-approved rate. . . . Such a "trapping" of costs is prohibited.

Nantahala, 476 U.S. at 970. *See also Mississippi Power*, 487 U.S. at 372-73.

Beyond preventing the obvious unfairness of "trapped" costs, the filed rate doctrine also serves federalism interests. Because each affected state in an interstate power transaction may have the ability to shift certain costs away from its own consumers to utilities in other states, the Court has recognized that the conflicting needs of individual states must be subordinated to the interests of the system as a whole. *See Mississippi Power*, 487 U.S. at 376. The states are therefore precluded from evaluating a utility's transactions based solely on local conditions. *See id.*

The filed rate doctrine is more than a prohibition on a state's right to reexamine directly the rates on file with FERC, however. State regulatory authorities are also prohibited from reexamining other aspects of an interstate power transaction where the result would be to interfere with the utility's right to recover the FERC-approved wholesale rate. *Nantahala*, 476 U.S. at 966-67; *Northern Natural Gas Co. v. State Corporation Commission of Kansas*, 372 U.S. 84, 90-91 (1963). Thus, for example, if two utilities obtain power from a single source, and FERC accepts an allocation of power between the utilities from that source, the states may not set retail rates that are based on some other allocation scheme. *See Mississippi Power*, 487 U.S. at 371 ("FERC's exclusive jurisdiction applies not only to rates but also to power allocations that affect wholesale rates").

One important feature of the filed rate doctrine is that the preemptive effect of a filing occurs even if FERC has not taken some affirmative action. Once a wholesale rate has been filed, a state may not interfere with its collection *regardless* of whether FERC in fact passes judgment on the reasonableness of the rate. Thus, this Court has said that the filed rate doctrine requires states to give binding effect to rates that either are "filed with FERC *or* fixed by FERC," *Nantahala*, 476 U.S. at 962 (emphasis added), and that states and utilities can "claim no rate as a legal right that is other than the filed rate, whether fixed or merely accepted by the Commission." *Montana-Dakota Utilities*, 341 U.S. at 251. *See also Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 581 (1981). In short, once a matter that is within FERC's exclusive jurisdiction is filed, states are preempted from regulating in a way that affects that same matter.

2. *Federal Preemption Of The PUC's Decision.*

The application of federal preemption principles to the current case should have been straightforward. Penn Power and Cleveland Electric entered into a binding agreement for the interstate sale and buyback of power, a transaction squarely within FERC's exclusive jurisdiction. As required by the Federal Power Act, the rates to be paid for the buyback were filed with and accepted by FERC. Accordingly, the PUC should have been preempted from issuing orders that "trapped" or otherwise interfered with Penn Power's ability to collect in its retail rates the costs incurred pursuant to the buyback. *Cf. Chicago and North Western Transp. Co. v. Kalo Brick & Tile*, 450 U.S. 311, 319 (1981) (a state's "efforts to regulate

commerce must fall when they conflict with or interfere with federal authority over the same activity").[9]

Nevertheless, the Commonwealth Court ruled that the filed rate doctrine did not apply, and that the PUC was free to regulate the 12 MW transaction as long as it did not explicitly reassess the wholesale rates. In reaching this result, the court below purported to distinguish *Mississippi Power* and *Nantahala*; the distinction it drew, however, cannot be reconciled with federal preemption principles in general, or the opinions in those cases in particular. The Commonwealth Court's misapplication of this Court's case law, and its resulting approval of state authority over an area of exclusive federal jurisdiction, warrant review by this Court.

The dispute in *Nantahala* involved the allocation of low-cost electrical power between two affiliated utility companies. FERC had reviewed the allocation that was filed by the utilities, and ordered an adjustment in the percentages of low-cost power that each was to receive. *See Nantahala*, 476 U.S. at 958. The relative availability of the low-cost power was then factored into the utilities' proposed retail rates, which were submitted to the North Carolina Utilities Commission ("NCUC") for review. The NCUC, however, set the retail rates as if the utilities were receiving a greater

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[9] Although the text of the buyback agreement was not filed with FERC, FERC recognized that its Order approving the filed rates was specific to the Perry 1 buyback. *See* notes 2, 5, *supra*. Particularly under these circumstances, the fact that the agreement itself was not filed does not change the analysis set forth above, because, *inter alia*, the PUC's order plainly traps wholesale costs in the very way found impermissible in *Nantahala* and *Mississippi Power*.

amount of low-cost power than they were in fact receiving under FERC's allocation. The impact of the order was to disallow some of the wholesale costs that were incurred pursuant to the FERC-filed rates. The question presented to this Court was whether the NCUC order violated the filed rate doctrine.[10]

This Court held that the state utility commission was preempted from reexamining the FERC-mandated allocation. When a state utility commission sets a utility's retail rates, said the Court, it "must allow, as a reasonable operating expense, costs incurred as a result of paying a FERC-determined wholesale price." *See id.* at 965. Given that "FERC's allocation of [low cost] power to Nantahala is . . . reflected in Nantahala's filed rates," the Court concluded that a state-mandated change in the allocation would inevitably affect those filed rates. *Id.* at 969, 970. This could lead to the trapping of the wholesale costs paid by the utility, said the Court, a result that was impermissible.

The current case is substantially similar to *Nantahala.* Penn Power and Cleveland Electric have allocated 12 MW of power between themselves, the immediate result of which was to shift temporarily millions of dollars in costs from Ohio to Pennsylvania ratepayers. As perhaps might be expected, the Pennsylvania PUC, like the NCUC in *Nantahala,* attempted to avoid these costs by examining the alloca-

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[10] The NCUC determined that Nantahala Power & Light should be treated as though it were receiving 24.5% of the low-cost power, rather than the 22.5% it was in fact receiving under the FERC allocation scheme. *Id.* at 960-61. The retail rates set by NCUC therefore did not compensate Nantahala for some of the higher-cost power that it was obligated to buy.

tion decision; although the PUC recognized that the rate itself could not be changed, it concluded that it was free to second-guess the decision to *pay* that rate for the 12 MW. In each case, the state utility commission then set retail rates at a level that impermissibly trapped part of the wholesale costs that the utility was obligated to pay.

The Commonwealth Court's attempt to distinguish *Nantahala* rests on a single point: in *Nantahala*, FERC evaluated and set the allocation among the parties, while in this case it did not. The court below reasoned that as long as Penn Power's decision to buy back the 12 MW was "voluntary"—*i.e.*, agreed to by private contract rather than compelled by FERC—the PUC was not precluded from questioning the reasonableness of that decision. Stated differently, the Commonwealth Court concluded that it does not interfere with the *rates* on file with FERC if all the PUC has done is rule that Penn Power was unjustified in purchasing this *quantity* of power, a decision that was not reviewed by FERC in this case. App. 20a.

Even if the Commonwealth Court's distinction between obligations "imposed" by FERC and those simply "permitted" by FERC could be reconciled with the reasoning of *Nantahala*—which it cannot—such a distinction was squarely rejected in *Mississippi Power*. In that case, several affiliated utilities *voluntarily* entered into a pooling agreement to construct and operate a nuclear generating plant. The agreement contained a formula for allocating the relatively high-cost power that was to be produced; this formula was then slightly adjusted by FERC after filing. *See Mississippi Power*, 487 U.S. at 361 n.7, 363. In a subsequent rate proceeding, the state utility commission allowed the utility to increase its rates ac-

cordingly, but the Mississippi Supreme Court reversed, and ordered the state commission to investigate, *inter alia*, both the reasonableness of the power allocation *and* the reasonableness of the decision to enter into and remain in the private agreement to construct and operate the nuclear facility. *See id.* at 366-68. With respect to the latter agreement, the Mississippi court found that FERC " 'was never presented with the question of whether the completion of [the facility], or its continued operation, was prudent.' " *Id.* at 368 (quoting Mississippi Supreme Court opinion). The Mississippi court therefore rejected the argument that state review was preempted under *Nantahala*.

This Court reversed, holding that the state utility commission was preempted from reviewing the prudence of this private agreement *even though* the matter had never been addressed by FERC. *Id.* at 374. The Court found that "[t]he Mississippi Supreme Court erred in adopting the view that the pre-emptive effect of FERC jurisdiction turned on whether a particular matter was actually determined in the FERC proceedings." *Id.* The Court added that it has "long rejected" a case-by-case analysis of the impact of state regulation on matters concerning the federal interest in interstate power. *Id.* Instead, said the Court, the decisive question for preemption purposes was simply whether a particular issue fell within FERC's jurisdiction; this included not only the wholesale rates themselves, but any agreements that "affect[]" wholesale rates. *Id.* Thus, even though the agreement to construct the power plants had been privately and voluntarily signed by the utilities, and even though FERC had never approved the agreement, this Court held that the state could not inquire into the utility's "decision to be a party to

agreements to construct and operate [the power plant] without traversing matters squarely within FERC's jurisdiction." [11] *Id.* at 376 (footnote omitted).

The Court in *Mississippi Power* also noted that the utility commission and others who questioned the reasonableness of the initial agreement could have objected in the proceedings before FERC, but failed to do so. "The question of prudence was not discussed," said the Court, "because no party raised the issue, not because it was a matter beyond the scope of FERC's jurisdiction." *Id.* at 375.

The Commonwealth Court's decision is plainly contrary to *Mississippi Power*. The parties in this case voluntarily entered into an agreement to allocate power from Perry 1, just as the utilities in *Mississippi Power* voluntarily agreed to construct and operate a nuclear power plant. In neither case was the reasonableness of the private agreement addressed by FERC. Nevertheless, the Commonwealth Court in this case ruled that because the Perry 1 buyback was not "mandated" by FERC, the state was free to reexamine Penn Power's decision to engage in that transaction, regardless of the effect the PUC's order had on wholesale rates. *Mississippi Power* makes it clear that the Commonwealth Court's attempt to avoid preemption on this basis cannot stand.

The lower court's rejection of the clear import of *Nantahala* and *Mississippi Power* rests in part on

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[11] As to the Mississippi Supreme Court's order that the state utility commission reexamine the FERC-mandated allocation formula, this Court had little difficulty in concluding that the order was contrary to *Nantahala*: "States may not alter FERC-ordered allocations of power by substituting their own determinations of what would be just and fair." *Id.* at 371.

dicta from those decisions. In *Nantahala*, the Court said:

> *Without deciding this issue*, we may assume that a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower cost power is available elsewhere, even though the higher cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, *price*.

476 U.S. at 972 (initial emphasis added). *Cf. Mississippi Power*, 487 U.S. at 373-74 ("it might well be unreasonable for a utility to purchase unnecessary quantities of high-cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power"). Based on this language, the Commonwealth Court found that this Court has "acknowledged a limitation" on the filed rate doctrine. *See* App. 17a. The lower court therefore concluded that the governing case was its pre-*Nantahala* and pre-*Mississippi Power* decision in *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission*, 77 Pa. Commw. 268, 465 A.2d 735 (1983).[12]

The lower court's belief that the quoted *dicta* create an exception to traditional preemption principles is entirely unwarranted. It can no longer be doubted that when a utility purchases a certain quantity of power pursuant to an interstate reallocation scheme,

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[12] In *Pike County*, a parent wholesaler sold electrical power to its subsidiary retailer pursuant to an agreement that was filed with FERC. The Commonwealth Court affirmed a finding by the PUC that the subsidiary acted imprudently in agreeing to purchase this power, when less-expensive supplies of electricity were available elsewhere. The court in that case rejected an argument that the PUC's authority was preempted by the Federal Power Act. *See Pike County*, 465 A.2d at 737-38.

FERC has jurisdiction over the transaction; the holdings of *Mississippi Power* and *Nantahala* make this point clear. The *dicta* therefore cannot apply to regulatory jurisdiction over purchases of power mandated by such agreements.

Moreover, the application of this purported exception to the current case is inconsistent with the rationale for the filed rate doctrine. *See Mississippi Power*, 487 U.S. at 372-73. By indirectly attacking the rate that has been filed with FERC through the guise of reexamining a decision to purchase a certain quantity of power, a state utility commission creates just as great a risk of interfering with the federal regulatory scheme as if it had attacked the rate directly.[13] As this case demonstrates, by simply purporting to change the focus of its inquiry from the rate to the quantity, a state may still cause a utility's costs to be trapped, thereby undermining an interstate transaction that is supposed to be regulated by FERC alone.

The decision below raises an important question about FERC's jurisdiction over interstate energy transactions. The lower court's decision not only conflicts with the case law of this Court, but in carving out an exception to the filed rate doctrine based on particular facts (*e.g.*, whether FERC "mandated" the agreement in question), the court below also has violated this Court's directive in a related context:

> our decisions have squarely rejected the view . . . that the scope of [FERC's] jurisdiction over

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[13] In this case, despite its claim that it was examining the quantity of power and not the rate, the PUC allowed Penn Power to recover the costs of the *same* quantity of power as was involved in the Perry 1 buyback, but at a lower assumed price.

> interstate sales of gas or electricity at wholesale is to be determined by a case-by-case analysis of the impact of state regulation upon the national interest. Rather, Congress meant to draw a line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis.

Federal Power Commission v. Southern California Edison Co., 376 U.S. 205, 215-16 (1964). *See also Mississippi Power*, 487 U.S. at 374. The court below has ignored the boundaries of the filed rate doctrine, and in the process has blurred the line between federal and state jurisdiction. Certiorari should be granted to reaffirm and clarify the scope of FERC's preemptive authority.

B. THE COURT MAY WISH TO HOLD THIS PETITION PENDING A RESOLUTION OF *NEW ORLEANS PUBLIC SERVICE INC. v. COUNCIL OF THE CITY OF NEW ORLEANS*

On April 22, 1991, this Court granted certiorari in *New Orleans Public Service Inc. v. Council Of The City Of New Orleans*, No. 90-1156 (*"NOPSI"*), a case that presents an issue related to the one raised here. In *NOPSI*, the Court will be asked to determine whether states are preempted from reexamining the reasonableness of a public utility's conduct, when the result of that reexamination is to trap wholesale costs that FERC has already found to be just and reasonable, and which the utility was required to incur. *See* App. 54a (Question Presented in *NOPSI* petition for certiorari). The Court's opinion in *NOPSI* will almost certainly address the preemptive effect of matters on file with FERC, and therefore is likely to have a bearing on the validity of the decision below. Accordingly, the Court may wish to

defer a ruling on this petition pending a decision in *NOPSI*.

In *NOPSI*, several affiliated utilities were members of an integrated power pool that planned to construct nuclear power facilities, including the Grand Gulf 1 plant in Mississippi. The power from Grand Gulf 1 was allocated among the members according to a Unit Power Sales Agreement. When that Agreement was filed, FERC adjusted the power allocation, but implicitly concluded that the initial decision to construct Grand Gulf 1 was a reasonable one. *See New Orleans Public Service Inc. v. Council Of The City Of New Orleans*, 911 F.2d 993, 996-97 (5th Cir. 1990), *cert. granted*, 111 S. Ct. 1617 (1991).

The Council of the City of New Orleans subsquently refused to allow one of the utilities to recover in retail rates $135 million of the costs it had incurred in connection with the decision to construct Grand Gulf 1. In the court of appeals, the utility argued that the Council's order was preempted under the filed rate doctrine, and specifically relied on *Nantahala* and *Mississippi Power* to support its position. *See id.* at 997, 999.[14] The court of appeals ruled that the New Orleans Council was not facially preempted from reexamining the utility's costs. *Id.* at 1001-02.

In its petition for certiorari, the utility pointed out that the state's reexamination of the FERC-approved

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[14] The Council took the position that its decision did not interfere with any of the agreements or rates on file with FERC, and that instead, it simply was assessing the reasonableness of the utility's decision to continue to participate in the Grand Gulf project after the alleged risks of the project became apparent. *See NOPSI*, 911 F.2d at 997.

transaction was contrary to *Mississippi Power* and *Nantahala*. The utility also noted that the proper interpretation of the filed rate doctrine was a mattter of great importance, and that the court of appeals' decision could potentially frustrate the national regulatory scheme that governs interstate wholesale power transactions. FERC, as *amicus curiae* supporting the petitioner, agreed that there is a conflict between the court of appeals' decision and the case law of this Court. It also urged the Court to grant certiorari to make it clear that the scope of FERC's exclusive authority over a matter should be determined by a bright-line test, not a case-by-case analysis. *See Amicus Curiae Brief of FERC Supporting Petitioner*, No. 90-1156, at 14.

The parallels to the current case are obvious. Most notably, in each case a state authority has attempted to avoid the preemptive effect of matters on file with FERC, on the ground that the filed rate doctrine simply does not reach the specific agreement being challenged. To the extent the Court in *NOPSI* addresses the scope or interpretation of *Mississippi Power* and *Nantahala*, or to the extent the Court addresses the contours of the filed rate doctrine generally, that opinion will affect the validity of the decision below.

CONCLUSION

The petition for a writ of certiorari should be granted. Alternatively, the Court may wish to hold the petition in this case, and dispose of it in light of the Court's decision in *New Orleans Public Service Inc. v. Council Of The City Of New Orleans*, No. 90-1156.

Respectfully submitted,

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June 18, 1991

APPENDICES

APPENDICES

APPENDIX A

SUPREME COURT OF PENNSYLVANIA

PENNSYLVANIA POWER COMPANY,
Appellant
v.
PENNSYLVANIA PUBLIC UTILITY COMMISSION

March 21, 1991

Appeal No. 103 W.D. Appeal Dkt.1989, from Order of Commonwealth Court, 127 Pa.Commw. 97, 561 A.2d 43 (1989), entered June 16, 1989, at No. 1317 C.D.1988, Affirming Order of Pennsylvania Public Utility Commission entered May 3, 1988, at Nos. G-870087, G-870088, M-870111 and R-870732.

Alan L. Reed, Morgan, Lewis & Bockius, Marc J. Sonnenfeld, Philadelphia, for appellant.

David M. Barasch, Consumer Advocate, Scott Rubin, Asst. Consumer Advocate, Office of Atty. Gen., Kevin J. Moody, Asst. Counsel, Pennsylvania Public Utility Com'n, Harrisburg, for appellee.

Prior report: 127 Pa.Comwlth. 97, 561 A.2d 43.

Before NIX, C.J., and LARSEN, FLAHERTY, McDERMOTT, ZAPPALA, PAPADAKOS and CAPPY, JJ.

ORDER

PER CURIAM:

Order affirmed.

CAPPY, J., dissents.

APPENDIX B

COMMONWEALTH COURT OF PENNSYLVANIA

No. 1317 C.D. 1988

PENNSYLVANIA POWER COMPANY,
Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent.

Argued March 8, 1989

Decided June 16, 1989

As Amended June 30, 1989

Alan L. Reed, Thomas P. Gadsden, Paul R. Bonney, Morgan, Lewis & Bockius, (James R. Edgerly, Vice President, Secretary and Gen. Counsel, Stephen L. Feld of Pennsylvania Power Co., of counsel), Philadelphia, for petitioner.

Kevin J. Moody, Asst. Counsel, Bohdan R. Pankiw, Deputy Chief Counsel and John G. Alford, Acting Chief Counsel, Harrisburg, for Pennsylvania Public Utility Com'n.

Scott J. Rubin, Asst. Consumer Advocate, Harrisburg, for intervenor, David M. Barasch, Consumer Advocate.

Before CRUMLISH, Jr., President Judge, and CRAIG, DOYLE, COLINS, PALLADINO, McGINLEY and SMITH, JJ.

CRAIG, Judge.

Pennsylvania Power Company (Penn Power or company) appeals from a decision of the Pennsylvania Public Utility Commission (PUC or commission) that refused to allow the company, under the energy cost rate (ECR) mechanism,[1] to include in its rates certain expenses incurred by the company as a result of a sale and buyback agreement with another utility. Penn Power raises issues of whether the commission's order is consistent with its subsidiary findings, whether such action by the commsision is pre-empted by federal law, and whether the order effects an unconstitutional taking of the company's property.

History

Penn Power is a regulated Pennsylvania public utility that is a wholly-owned subsidiary of Ohio Edison Company (Ohio Edison). In 1967, in response to

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[1] The ECR mechanism is provided by section 1307 of the Public Utility Code, 66 Pa.C.S. § 1307. The Pennsylvania Supreme Court explained the purpose of the ECR in the case of *Allegheny Ludlum Steel Corp. v. Pennsylvania Public Utility Commission*, 501 Pa. 71, 75-76 n. 3, 459 A.2d 1218, 1220 n. 3 (1983):

> The purpose of the ECR is to provide an automatic mechanism enabling utilities to recover specific *energy costs* not covered by general rates, by allowing collection of rates based on projected cost data for the calendar year. . . . The ECR determines, therefore, the amount per kilowatt hour which the customer pays in addition to the base rate. Undercollections and overcollections of realized energy costs are reconciled annually. (Emphasis added.)

predictions of increased demand for electricity, Penn Power joined with four other utilities to form the Central Area Power Coordinating Group (CAPCO),[2] for the purpose of constructing additional capacity. CAPCO originally planned to build seven large nuclear generating units. Later events, principally the oil embargo of the early 1970's and the nuclear accident at Three Mile Island, radically changed the outlook both for the growth of demand for electricity and for the use of nuclear power as a means of meeting that demand. In 1980 CAPCO decided to cancel plans for construction of four of the nuclear units. Penn Power asserts that, as part of the overall 1980 cancellation agreement, Cleveland Electric agreed to acquire 12 megawatts (Mw) of Penn Power's original 75 Mw share of Perry Unit No. 1, but in return for its agreeing to purchase that share, Cleveland Electric required Penn Power to buy back the power from that 12 Mw for a period of eighteen months, beginning on the date that Perry 1 achieved commercial operation. Costs of the buyback were to be determined in accordance with the terms and conditions set forth in the CAPCO Basic Operating Agreement on file with the Federal Energy Regulatory Commission (FERC). Perry 1 became operational on November 17, 1987.

On November 16, 1987, Penn Power filed with the PUC an interim energy cost rate to become effective December 1, 1987. Penn Power's interim ECR filing proposed to increase its energy cost rate from 1.741 to 6.768 mills per kilowatt hour (Kwh), attributing the need for such an increase in part to the costs

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[2] The other utilities are Ohio Edison, Duquesne Light Company, Cleveland Electric Illuminating Company (Cleveland Electric) and Toledo Edison Company.

associated with the 12 Mw Perry 1 buyback. The company's ECR filing projected the Perry 1 buyback costs to be approximately $1 million per month,[3] or $18 million total over the eighteen-month period of the buyback agreement, although a current market value for the same amount of power from other sources is only about $100,000 per month, or $1.8 million total.

The commission issued an order that initiated an investigation into the reasonableness of the interim ECR filing, accepted the company's proposal to synchronize its next ECR with the new rates to be set in Penn Power's base rate proceeding then pending before the commission, and permitted Penn Power to increase its ECR to 3.579 mills/Kwh temporarily. The temporary ECR increase did not include any allowance of recovery of costs of the Perry 1 buyback. The investigation into the ECR filing was assigned to Administrative Law Judge Michael A. Nemec (ALJ), who was also presiding over Penn Power's concurrent but separate base rate proceeding. The parties to both proceedings were the commission's Office of Trial Staff (OTS), the Office of Consumer Advocate (OCA) and the company.

The ALJ decided that allowing Penn Power to recover all of the costs of the Perry 1 buyback through the mechanism of the ECR would be unreasonable and hence unlawful. The ALJ stated that, because of his approval of the company's proposal to treat the buyback costs through the ECR, the proper evalua-

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[3] Schedule 3 accompanying Penn Power's ECR filing shows an "Interchanged Receipt" to Cleveland Electric for 26,400 Mwh of Perry 1 power at a cost of $5,014,000 for five months. R. 8a.

tion of the claimed costs involved "look[ing] at the transaction in terms of the reasonableness of the purchase at the present time." Supplemental Recommended Decision 23.

The ALJ declined to hold, as urged by OTS and OCA, that the Perry 1 buyback represented excess capacity on Penn Power's system, in part because he had held in the base rate case that the 63 Mw retained by the company was not excess. Further, he acknowledged that OTS and OCA had not formally disputed Penn Power's claim that its decision to sell the 12 Mw share of Perry 1 capacity to Cleveland Electric was prudent. However, the ALJ said that the dispute over including the buyback costs in Penn Power's ECR "centers on the need for the generation and its price in the context of an adjustable rate for the recovery of the costs of energy. Purely and simply, the incurrence of costs by Penn Power does not result in Penn Power being guaranteed recovery of those costs through its rates." *Id.* at 26. The ALJ noted that Penn Power had made no showing on the record before him that the 12 Mw of Perry 1 capacity would be needed during the eighteen months set by the agreement, nor had the company shown that, even if it were, less expensive power would not be available from other sources.

Consequently, the ALJ recommended that the commission treat the buyback costs according to the alternative method proposed by OCA—allowing the company to recover, through the ECR, the cost of a comparable volume of generation anticipated over the period of the buyback at a system average rate (thus allowing Penn Power to realize a gain to the extent of the difference between the system average cost of

energy and the lower energy component of the price of Perry 1 power), but otherwise disallowing costs associated with the buyback (thus charging the full amount of the high capacity component of the price of power from this particular source to Penn Power's shareholders, rather than to its ratepayers).[4]

The commission, on consideration of exceptions and replies to exceptions filed by all of the parties in the ECR case, issued an order essentially adopting the recommended decision of the ALJ. The only difference was the commission's direction that the method for calculating the system average rate to be paid to Penn Power not include the Perry 1 rate. The commission's order had the effect of disallowing over $16 million, or approximately 90%, of the costs that Penn Power will incur under the Perry 1 buyback.

Penn Power filed a petition for review with this court, questioning: (1) the disallowance of 90% of the buyback costs, (2) the commission's refusal to be bound by Federal Energy Regulatory Commission approval of Cleveland Electric's wholesale rate, (3) the

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[4] The price of any purchase of electric power is made up of an energy component, the variable costs associated with the production of electric energy (primarily the cost of fuel and some operating and maintenance expenses), and a capacity component, costs associated with providing the capability to deliver energy (primarily the capital costs of facilities). The *energy* component of the price of nuclear-generated power is typically quite low—the fuel and operating expenses of such a plant usually are less than those for a conventional facility. The high cost of nuclear-generated power results from the very high *capacity* component of the price for such power, i.e., the portion of the overall cost that relates to the enormous capital costs of building the nuclear facility.

alleged confiscatory effect of the commission's decision.

Our scope of review is limited to a determination of whether constitutional rights have been violated, an error of law committed or whether the findings, determinations or order of the commission is supported by substantial evidence in the record. *Pennsylvania Power & Light Co. v. Pennsylvania Public Utility Commission*, 101 Pa.Commonwealth Ct. 370, 516 A.2d 426 (1986).

Disallowance of Buyback Costs as an Excessive Expense

The PUC operates under a statutory mandate to assure that "[e]very rate made, demanded, or received by any public utility . . . shall be just and reasonable. . . ." Section 1301 of the Public Utility Code, 66 Pa. C.S. § 1301. The basic ratemaking formula by which the commission fulfills this duty provides that a utility's revenue requirement (RR) is equal to the amount of proper expenses (E) plus a reasonable rate of return (ROR) on the rate base (RB): $RR = E + ROR(RB)$.

Expenses include such items as the cost of operations and maintenance (labor, fuel and administrative costs, e.g.), depreciation and taxes. In Pennsylvania, fuel and purchased power expenses of electric utilities are recovered primarily through the energy cost rate mechanism, which allows a utility to recover highly variable operating expenses more quickly than it could by waiting to claim them in a future base rate case.

The rate of return is a rate determined by the commission to allow the shareholders the opportunity

to earn a reasonable return, or profit, on their rate base investment, in view of the level of risk involved.

The rate base is the value of the property of the utility that is used and useful in providing utility service.

A principle of exclusion from rate base applies when an electric utility builds or otherwise acquires capacity for generating power beyond the projected needs of its customers plus a reasonable reserve margin determined by the commission to be necessary to insure reliability of service. In such a case the amount of such excess capacity will be removed from the rate base.

Short-term purchases of power are not regarded as contributing to the purchasing utility's capacity, but rather as simple purchases of energy. *See generally* J. Cawley and N. Kennard, Rate Case Handbook, A Guide to Utility Ratemaking before the Pennsylvania Public Utility Commission 174-257, App. B 1-12 (1983) *and Allegheny Ludlum.*

In the present case, Penn Power argues that, because the commission held that the 12 Mw of capacity represented by the Perry 1 buyback did not result in excess capacity, and because the commission acknowledged that the sale and buyback agreement was prudent when made, no legal basis remains for disallowing any of the costs associated with the purchase.

However, the company's position is simply a reflection of the substantial conceptual and analytic difficulties engendered by the intrusion of *capacity* issues into this ECR proceeding, which was designed for the purpose of allowing expedited recovery of certain *operating expenses.* Simply stated, Penn Power did

not choose to claim the purchase of this 12 Mw of capacity for eighteen months as a temporary addition to its rate base in the concurrent base rate proceeding, and to recover the costs of the purchase of capacity by the normal means, that is, through the expense of depreciation plus the earning of a return on the value of the capacity. Rather, the company has sought to recover all of the costs of the buyback dollar-for-dollar as an *operating expense* in this ECR proceeding.

Although both the ALJ and the commission ruled on the excess capacity question, their ultimate treatment of the buyback costs was consistent with the reality that excess capacity questions and operating expense reasonableness are distinct matters. Because the company claimed the buyback costs as operating expenses, the ALJ and the commission analyzed them as operating expenses. The ALJ stated that the proper evaluation of the costs involved looking at the reasonableness of the purchase at the present time and that the dispute centered on "the need for the generation and its price in the context of an adjustable rate for the recovery of the costs of *energy*." (Emphasis added.)

The contention of OCA that the present case is indistinguishable from the case of *Pennsylvania Power & Light Co. v. Pennsylvania Public Utility Commission*, 101 Pa.Commonwealth Ct. 370, 516 A.2d 426 (1986) (*PP & L*), is incorrect. *PP & L* involved a utility's appeal from an order of the PUC in a general rate case. Among the actions of the PUC that the utility appealed was an excess capacity adjustment disallowing addition to the company's rate base of PP & L's 10% share of two nuclear generators, which the utility had acquired through a sale

and temporary buyback similar to the buyback involved in this case. This court affirmed the commission's order, quoting language from the case of *Philadelphia Electric Co. v. Pennsylvania Public Utility Commission*, 61 Pa.Commonwealth Ct. 325, 329, 433 A.2d 620, 623 (1981):

> The touchstone for determining whether or not a prudently constructed unit *should be included in a utility's rate base* is whether or not, during the test year involved, the unit will be used and useful in rendering service to the public. (Emphasis added.)

The distinction between *PP & L* and the present case is that in that rate case the utility claimed the disputed capacity as an addition to rate base, and the commission expressly found that the capacity was excess, whereas in this ECR proceeding the company has claimed capacity costs as expenses, and the commission expressly found that the capacity was not excess. Although the facts of the two cases are similar, the legal issues involved are distinct.

OCA argued both before the commission and before this court, apart from its excess capacity contentions, that the Perry 1 buy-back represented an unreasonable and excessive expense. One case cited by OCA bears a legal resemblance to the present case. *Duquesne Light Co. v. Pennsylvania Public Utility Commission*, 96 Pa. Commonwealth Ct. 398, 507 A.2d 1274 (1986), also concerned agreements involving Penn Power and CAPCO. In that case, CAPCO had entered into agreements with a mining company for the development of three underground mines in order to secure a long-term source of coal. The PUC instituted an investigation into the reasonableness of the

costs that Penn Power and Duquesne Light Company were paying for coal from those mines. OTS entered into a stipulation agreement with the companies setting forth a pricing method that included a price cap formula and an escalator clause recommended by consultants to the companies. The commission ultimately approved the stipulation agreement after substituting price cap and escalator mechanisms recommended by witnesses for OTS during hearings before an ALJ, which resulted in lower allowances for the cost of that coal.

Thus the companies' appeal to this court raised the issue of the commission's power to alter the method for calculating allowable *operating expenses*, which the company claimed through its ECR, in the face of a pre-existing, concededly prudent agreement establishing those expenses. This court first noted that the principle that costs resulting from managerial imprudence could be denied did not necessarily mean that prudently incurred costs would always be recovered, and we listed examples of utility cases where claimed expenses were disallowed without findings that the utilities had incurred them imprudently. *Duquesne Light*, 96 Pa.Commonwealth Ct. at 404, 507 A.2d at 1278. We then held:

> Prudence on the part of a utility in incurring certain expenses is no guarantee that it will recover those expenses dollar for dollar from its customers. *Utility rates must be just and reasonable when charged, a standard temporally, and therefore often actually quite removed from the prudence of the original arrangements for the products needed to supply the services for which the rates are later charged.*

Id. at 405, 507 A.2d at 1278 (emphasis added). As for the binding effect of the agreement in question, we said:

> The Commission never adopted the Stipulation Agreement, as the Companies suggest in their brief. *Just as a utility cannot, by entering into unsupervised agreements with third parties, deprive the Commission of its power to rule on the reasonableness of a utility's rates (National Fuel Gas Distribution Corp. v. Pennsylvania Public Utility Commission,* 76 Pa.Commonwealth Ct. 102, 464 A.2d 546 (1983)), it cannot bind the Commission by an agreement entered into with Trial Staff. *Glenside Suburban Radio Cab, Inc. v. Pennsylvania Public Utility Commission,* 49 Pa.Commonwealth Ct. 523, 411 A.2d 874 (1980).

Id. at 407, 507 A.2d at 1279 (emphasis added).

The principles for analyzing operating expenses set forth in *Duquesne Light* are equally applicable here. Penn Power's costs for purchased power that are claimed by the company as operating expenses for pass-through to its customers must be reasonable when they are claimed, and the prudence of the original decision to incur those expenses does not control their recovery. Also, Penn Power's entering into an unsupervised contract with Cleveland Electric in 1980 cannot deprive the commission of its power today to determine the reasonableness of expenses claimed under that contract.

Penn Power's decision to enter into that contract was voluntary. The company may have been under *economic* compulsion to sell a 12 Mw share of Perry 1 in 1980 and buy the energy back at a rate to be filed with FERC, but it was under absolutely no *govern-*

mental compulsion to do so, either by FERC or by the PUC; the agreement was completely unsupervised. Under these circumstances, the company (or, more precisely, its shareholders) assumed the risk that expenses resulting from the 1980 agreement might be held by the commission to be unreasonable when the company sought in the future to recover those expenses in rates. The same could be true for a labor contract or a contract for the supplying of coal.

Penn Power contends emphatically that its decision to incur these expenses should be evaluated by comparing these costs to those the company would have incurred had it retained ownership of the 12 Mw in question.[5] However, that argument goes only to the *prudence* of the company's decision in 1980. As we have shown, the prudence of the initial decision to incur particular *expenses* is not determinative of whether those expenses may properly be allowed when they are ultimately claimed in rates.

Although the commission's route to its ultimate determination involved an excursion into excess capacity analysis, the commission's ultimate ruling on the Perry 1 buyback costs was based on an analysis of those costs as expenses, which was how the company was claiming them, and a conclusion that those expenses were unreasonable. That conclusion was

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[5] As OCA points out, the company's claim that the sale and buyback saved its ratepayers some $45 million compared with retained ownership rests on the highly speculative assumption that the PUC would have permitted the company to recover *from ratepayers* all costs associated with the 12 Mw share throughout the life of Perry 1, regardless of other circumstances.

based on a finding, derived in part from the company's own evidence, that the claimed cost of Perry 1 power was roughly ten times that available from other sources. The commission's conclusion was legally correct, and the findings on which it was based are supported by substantial evidence in the record.

The Filed Rate Doctrine

Penn Power's second argument is that the PUC is pre-empted from disallowing expenses resulting from the Perry 1 buyback agreement because the rate at which Perry 1 power is sold is a rate filed with the Federal Energy Regulatory Commission, and a state regulatory authority is barred by the "filed rate" doctrine from disallowing expenses incurred as a result of a purchase of power at a FERC-approved rate. For this proposition the company relies primarily on two recent United States Supreme Court decisions, *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 106 S.Ct. 2349, 90 L.Ed.2d 943 (1986) and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, —— U.S. ——, 108 S.Ct. 2428, 101 L.Ed.2d 322 (1988).[6]

In *Nantahala*, two commonly-owned utility companies turned most of the variable power they produced over to the Tennessee Valley Authority, and in return they received jointly from the authority a fixed and reliable supply of low-cost "entitlement power," which they allocated between themselves, with *Nan-*

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[6] The Supreme Court issued its decision in *Mississippi Power & Light* after the PUC issued its decision in the present case. Although the parties disagree as to the meaning of the Supreme Court's decision, they agree that it is applicable to the determination of this case.

tahala receiving 20%. Nantahala also had a contractual right to buy higher cost "purchase power" from the authority. In setting Nantahala's interstate wholesale power rates, FERC decided that the companies' allocation of entitlement power was unfair. FERC allocated 22.5% of the entitlement power to Nantahala and required the company to submit appropriate rates. Later, the North Carolina Utilities Commission (NCUC), in reviewing Nantahala's request to raise its intrastate retail rates, decided that the company should be regarded as receiving 24.5% of the entitlement power, for the purpose of determining the company's costs. That decision was upheld by the North Carolina courts.

On review, the Supreme Court first observed that FERC has exclusive jurisdiction over interstate wholesale power rates pursuant to 16 U.S.C. § 824(b). The Court noted that the "filed rate" doctrine holds in pertinent part that interstate power rates filed with FERC or fixed by FERC must be given binding effect by state utility commissions determining intrastate rates. Tracing the origin of that doctrine to the case of *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 71 S.Ct. 692, 95 L.Ed. 912 (1951), the Court noted that the doctrine is not a rule of administrative law but rather a matter of enforcing the Supremacy Clause of the Constitution. Further, the Court stated that the doctrine was not limited to rates per se, but was also involved where, as in the case before it, FERC's allocation, of the amount of low-cost power that a utility could obtain, directly affected interstate rates, and FERC had ordered the company to file rates in accordance with that allocation.

The Court observed that NCUC's order calculating Nantahala's costs as if it received more low-cost power than FERC had expressly allocated to it had the same effect as if a state agency refused to allow a middleman faced with a FERC-fixed wholesale price charged by a supplier to recover those costs in its rates. "The fact that NCUC is setting retail rates does not give it license to ignore the limitations that FERC has placed upon Nantahala's available sources of low-cost power." 476 U.S. at 970, 106 S.Ct. at 2539. The Court held that "[FERC's 22.5%] allocation, reflected as it is in a filed rate, must be respected by NCUC. If, as a result, Nantahala needs to purchase additional power from some non-entitlement source, that need is a reasonable one." *Id.* at 972, 106 S.Ct. at 2360.

However, immediately upon announcing this holding, the Court acknowledged a limitation upon it:

> Accordingly, the North Carolina Supreme Court erred in relying on cases treating the reasonableness of purchasing from a particular source of, rather than paying a particular rate for, FERC-approved power. See *Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n*, 77 Pa Commw 268, 273-274, 465 A2d 735, 737-738 (1983); *Kansas-Nebraska Natural Gas Co. v. State Corporation Comm'n*, 4 Kan App 2d 674, 679-680, 610 P2d 121, 127 (1980). Without deciding this issue, we may assume that a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained

> at a FERC-approved, and therefore reasonable, *price.*

Id. (emphasis in the original).

The Supreme Court's reference to this court's decision in *Pike County Light and Power Co.* was not a disapproval of the holding of that case, but rather a conclusion that the North Carolina Supreme Court erred by applying that holding in inappropriate circumstances. *Pike County Light and Power* involved a claim for recovery of purchased power expenses in a situation where a small Pennsylvania electric retail utility, Pike County Light and Power Company, bought all of the energy it sold at retail from a New York state operating company that was its parent, Orange & Rockland Utilities, Inc. Hence Pike's purchases were in interstate commerce at rates approved for the parent by FERC. This court acknowledged that any attempt by the PUC to regulate the rates in the agreement between the utility and its parent would be pre-empted. However, we emphasized that the section of the Federal Power Act of 1935 that established exclusive federal regulation over matters relating to transmission of electric energy in interstate commerce also expressly reserved some powers for the states: "[S]uch Federal regulation, however, [is] to extend only to those matters which are not subject to regulation by the states." 16 U.S.C. § 824(a).

We found persuasive OCA's argument that the PUC's regulation of the Pennsylvania utility's retail rates did not involve a state analysis or determination of the reasonableness of the FERC rates:

> The FERC focuses on Orange & Rockland to determine whether it is just and reasonable *for*

> *that company to charge* a particular rate, but makes no determination of whether it is just and reasonable *for Pike to incur* such a rate as an expense. The PUC focuses on Pike and its cost of service data to determine whether it is reasonable for Pike to incur such costs in the light of its available alternatives. So while the FERC determines whether it is against the public interest for Orange & Rockland to charge a particular rate in light of its costs, the PUC determines whether it is against the public interest for Pike to pay a particular price in light of its alternatives. The regulatory functions of the FERC and the PUC thus do not overlap, and there is nothing in the federal legislation which preempts the PUC's authority to determine the reasonableness of a utility company's claimed expenses. In fact, we read the Federal Power Act to expressly preserve that important state authority.

Pike County Light and Power Co. v. Pennsylvania Public Utility Commission, 77 Pa.Commonwealth Ct. 268, 274-75, 465 A.2d 735, 738 (1983) (emphasis in the original, footnote omitted).

The difference between *Nantahala* and *Pike County Light and Power* is apparent. In *Nantahala* the state commission's refusal to abide by FERC's express allocation of cheap power had the effect of trapping FERC-mandated costs because the utility had no other source of cheap power available to it. In *Pike County Light and Power* the rate at which the utility bought from its parent was set by FERC, but the agreement to purchase at that rate was completely voluntary. *FERC did not mandate the purchase*; hence the PUC was free to consider whether Pike's

decision to buy at that FERC-approved rate was justified, in the light of the availability of alternative sources of cheaper power.

The circumstances of the present case are analogous to those of *Pike County Light and Power* and are squarely within the limitation recognized by the Supreme Court in *Nantahala*. As was noted in the discussion of the first issue above, Penn Power's decision to enter into the sale and buyback agreement with Cleveland Electric was completely voluntary. Because FERC did not mandate the particular purchase involved in this case, or otherwise limit Penn Power's options for purchasing power, the PUC's decision here is simply a state determination that Penn Power's agreement to purchase the *quantity* of power specified in the 1980 agreement at the FERC-approved rate was unreasonably excessive when lower cost power was readily available elsewhere. The PUC's decision does not constitute an impermissible state determination that FERC-approved rates are not reasonable nor does it result in the trapping of costs that FERC has ordered a utility to incur.

Penn Power attempts to distinguish *Pike County Light and Power* by arguing that that decision rested on a finding that the company's management acted imprudently, and that no such finding has been made here. In fact, the finding of imprudence in that case was a consequence of the finding that the purchased power expense was unreasonably excessive (a determination that necessarily involved comparison to other available sources of cheaper power). We affirmed the PUC's disallowance of a portion of that expense because it was excessive, not because management was imprudent in incurring it.

Penn Power next claims that this case is different because it did not have the luxury of choosing, in 1987, among competing suppliers of energy. This argument in effect merges with the company's third asserted basis for distinction, a claim that the company did not have the legal right to refuse to buy the high-cost Perry 1 power *because of* the 1980 agreement. This argument is circular. Pike County Light and Power was bound by agreements with its out-of-state supplier as well. The issue in that case was whether expenses incurred under those agreements were reasonable, and hence recoverable in rates, not whether the company had any legal right to refuse to buy that power. Further, Penn Power cannot seriously maintain that *in 1980* it was not aware of sources of purchased power that would be cheaper than that ultimately produced by Perry 1. The company constrained its own choices in 1980 because the buyback was part of the sale of the 12 Mw sale. By the company's own description, the buyback purchase did not result from an objective examination of the market in 1980 for the delivery of power in 1987. The fact that Penn Power voluntarily agreed to the buyback because it wanted to sell the 12 Mw share of Perry 1 cannot be transformed into a finding that the company had no other alternatives.

Mississippi Power & Light v. Mississippi ex rel. Moore, —— U.S. ——, 108 S.Ct. 2428, 101 L.Ed.2d 322 (1988), does not undermine the above analysis in any way. In that case FERC had ordered an allocation among sister operating companies, making up a fully integrated multistate power pool, of the burden of purchasing extremely expensive power produced by a newly completed nuclear generating facility built at the direction of the parent holding com-

pany. The Mississippi Supreme Court ruled that the state utility commission had exceeded its authority by permitting a Mississippi member of that system to recover its costs under that allocation as operating expenses, without first conducting an inquiry into whether the company's purchase was prudent. The United States Supreme Court held that the state court's order accomplished the same kind of violation of the Supremacy Clause as was present in *Nantahala*. *Mississippi Power & Light* again involved a state's purporting to exercise power to evaluate the reasonableness of a utility's purchase, at a FERC-approved rate, pursuant to a FERC-mandated *allocation*. No such federal compulsion for Penn Power to buy back Perry 1 power was present in this case.

Confiscation

Penn Power's final contention is that the PUC' denial of recovery of expenses the company has incurred under its Perry 1 buyback agreement effects a taking of its property without just compensation, in violation of the Fifth and Fourteenth Amendments to the Constitution of the United States. As OCA points out, Penn Power did not raise this issue before the PUC but rather advances its confiscation argument for the first time on appeal. This issue does not appear among those raised in the company's exceptions to the ALJ's recommended decision or in its reply to exceptions. R. 93a-109a, 128a-133a. Pa. R.A.P. 1551(a) provides in part that no question shall be heard or considered by this court that was not raised before the government unit, except questions involving the validity of a statute or the jurisdiction of the government unit over the subject matter or questions that the court is satisfied the peti-

tioner could not by the exercise of due diligence have raised before the government unit. Because none of the exceptions applies here, we shall not consider this argument.[7]

Accordingly, the order of the Public Utility Commission is affirmed.

ORDER

NOW, June 16, 1989, the opinion and order of the Pennsylvania Public Utility Commission at Docket Nos. G-870087, G-870088, M-870111 and R-870732, entered May 3, 1988, is affirmed.

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[7] Moreover, the confiscation claim has not been successful. Penn Power itself has advanced essentially the same argument previously before this court, the Pennsylvania Supreme Court and the United States Supreme Court, only to have it rejected each time. *See Duquesne Light Co. v. Pennsylvania Public Utility Commission*, 96 Pa. Commonwealth Ct. 398, 507 A.2d 1274 (1986), *and Barasch v. Pennsylvania Public Utility Commission*, 516 Pa. 142, 532 A.2d 325 (1987), *aff'd sub nom. Duquesne Light Co. v. Barasch*, —— U.S. ——, 109 S.Ct. 609, 102 L.Ed.2d 646 (1989). The same argument also has been rejected when advanced by others. *See, e.g., Pennsylvania Electric Co. v. Pennsylvania Public Utility Commission*, 509 Pa. 324, 502 A.2d 130 (1985), *appeal dismissed sub nom. Metropolitan Edison Co. v. Pennsylvania Public Utility Commission*, 476 U.S. 1137, 106 S.Ct. 2239, 90 L.Ed.2d 687 (1986).

APPENDIX C

PENNSYLVANIA PUBLIC UTILITY COMMISSION

RE PENNSYLVANIA POWER COMPANY

ADDITIONAL APPLICANT: OHIO ENERGY COMPANY

G-870087

RE INTERIM ENERGY COST RATE—
PENNSYLVANIA POWER COMPANY

G-870088

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PENNSYLVANIA POWER COMPANY

M-870111, R-870732

April 28, 1988; entered May 3, 1988

Before Shane, chairman, Smith, vice chairman, and Taliaferro and Fischl, commissioners.

By the COMMISSION:

OPINION AND ORDER

Before the Commission is the *Supplemental Recommended Decision* ("SRD") of Administrative Law Judge ("ALJ") Michael A. Nemec issued on March 25, 1988 in the above-referenced dockets. Exceptions

thereto were duly filed by the Respondent, Pennsylvania Power Company ("Penn Power" or "Company"), the Office of Consumer Advocate ("OCA") and the Office of Trial Staff ("OTS").

Brief History

On November 16, 1987, the Pennsylvania Power Company filed two Affiliated Interest Agreements for approval by the Commission in accordance with the requirements of Section 2102(b) of the Public Utility Code, 66 Pa. C.S. § 2101(b).

The First Affiliated Interest Agreement, dated October 20, 1987, supplements the existing 1987 Agreement between Penn Power and Ohio Edison regarding the allocation of installed capacity between the two companies. This agreement, docketed at G-870087, provides for the purchase by Penn Power from Ohio Edison of 13 MW (from Mansfield Unit No. 1) during the 44-day period from November 17, 1987 (the date Beaver Valley Unit No. 2 was placed into commercial operation) to December 31, 1987.

The second Agreement, docketed at G-870088 and dated December 31, 1987, provides for the sale by Penn Power to Ohio Edison of 21 MW (14 MW from Beaver Valley Unit No. 1 and 7 MW from Sammis Unit No. 7) for a one-year period beginning January 1, 1988.

On November 16, 1987, Penn Power filed an interim energy cost rate ("ECR"), docketed at M-870111, to become effective on the effective date of its new base rates and next ECR. In its filing, the Company proposed to raise its ECR by 5.027 mills/KWH from 1.741 to 6.768. By Order entered Jan-

uary 22, 1988, we approved Penn Power's proposal to synchronize the effective date of its new base rates authorized in Docket R-870732 and its next ECR.

In our January 22, 1988 Order at Docket No. M-870111, we permitted the Company to reflect the impact of the second Affiliated Interest Agreement (i.e., the 21 MW sale in 1988, docketed as G-870088) which served to reduce the existing credit being flowed through the ECR. We did not, however, authorize current recovery of the costs associated with the shorter-term, 13 MW purchase agreement (Docket G-870087), and we indicated that ultimate recovery of all costs incurred under both Agreements was subject to our decisions at Docket Nos. G-870087 and G-870088.

The interim ECR filing reflected the costs associated with the Company's eighteen-month buy-back of 12 MW of Perry 1 generating capacity from Cleveland Electric. In our Order of January 22, 1988, we did not authorize the Company to increase its ECR to recover those costs, but initiated an investigation (docketed at M-870111) into their reasonableness. As a result of all the foregoing, the Company was authorized to increase its ECR, on an interim basis, to 3.579 mills/KWH.

These proceedings were consolidated before ALJ Nemec for disposition. As part of the consolidation, Penn Power agreed to extend the date for an order on the two affiliated interest agreements until May 4, 1988.

1. *Docket No. G 870088*

Regarding the 1988 Affiliated Interest Agreement (AF-88), all the parties were in agreement that the provisions were reasonable and should be imple-

mented. Other than certain generic criticisms leveled at the overall relationship between Ohio Edison and Penn Power which are dealt with more directly later, no party filed exceptions to the ALJ's Recommended Decision in Docket No. G-870088. We are persuaded that the 1988 Affiliated Interest Agreement is reasonable and should be implemented.

2. *Docket No. G-870087*

The ALJ found the affiliated interest agreement under consideration herein to be unreasonable and inconsistent with public policy and recommended that it be disapproved. The ALJ grounded his recommended decision on the observation that it involved an *unexplained* one time, short-term adjustment to a previously approved agreement. Although the Company disagreed with the ALJ's recommendation, it chose not to file Exceptions on this issue. We concur with the ALJ that this significant unexplained departure from prior procedure requires us to deny the Company's request for approval of this affiliated interest agreement, pursuant to 66 Pa. C.S. § 2102, and recovery of the associated capacity charges is hereby denied. The Company is authorized to recover only the energy charges for the purchase.

3. Docket No. M-870111

The ECR investigation contained several issues: (1) the Company's request for recovery, through the ECR mechanism, of the 18 months of Perry 1 power; (2) an OCA request the Commission to impose guidlines upon the Company to govern future Buy/Sell agreements; and (3) the Company's request to flow certain capacity charges/credits through the ECR and delete them from base rates. Each of these issues will be dealt with *seriatim*.

a. *Perry 1 18 Month Buy Back*

The Company requested approval to charge ratepayers for eighteen months of 12 MW of capacity from Perry 1. The addition of the 12 MW of capacity does not result in excess capacity as discussed in our base rate decision in Docket R-870732. However, the Company did not demonstrate that there was *any need* for an additional 12 MW of generation capacity during the period in question or that the purchase was less expensive than *any* alternative. In this regard, the material fact here, as noted by the ALJ, is that the Commission is reviewing a *purchase* of electrical capacity by a Pennsylvania utility for retail sale to Pennsylvania ratepayers. The sole issue for our resolution, as properly framed by the ALJ, is "the need for the generation and its price in the context of an adjustable rate for the recovery of the costs of energy" (R.D., p. 26). The ALJ found that there was no demonstrated need for Penn Power to purchase this very expensive capacity and, therefore, recommended that it not be reflected in the Energy Cost Rate. However, the ALJ did recommend that Penn Power be authorized to recover the cost of a comparable volume of generation anticipated over the period of the buy-back at an average system cost of all energy utilized in its system, *including* Perry 1.

The Company excepted to the ALJ's recommendation and argued that the Perry 1 capacity purchase was an integral part of a transaction which was equivalent to a partial cancellation of Penn Power's ownership share in Perry 1. Second, the Company argued that the Federal Energy Regulatory Commission ("FERC") has preempted this Commission's authority to examine the price paid for Perry 1 capacity. Third, the Company argued that there was

not an equitable sharing of the buyback agreement between ratepayers and shareholders because the ALJ's Recommended Decision denies the Company recovery of 90 to 95 percent of its costs, or between $16-$17 million of its aggregate liability under the buy back of approximately $18 million.

We find that the Company's exceptions are without merit. The Federal preemption argument fails, as the ALJ noted, because "the FERC does not review the justness and reasonableness of the purchase by the buying utility (or the recovery of the expense of the purchase by the buying utility)" (R.D., p. 24). See also *Pennsylvania Pub. Utility Commission v. Pike County Light & P. Co.*, 56 Pa. PUC 371 (1982) and *Pike County Light & P. Co., v. Pennsylvania Pub. Utility Commission*, —— Pa.Cmwlth. ——, 465 A.2d 735 (1983). We concur with the ALJ that *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 74 PUR4th 464, 90 L.Ed.2d 943, 106 S.Ct. 2349 (1983) is irrelevant to our decision herein because we are merely reviewing the purchase of a particular quantity of power which we have found to be unreasonably excessive and unnecessary for Penn Power to provide safe and reliable service to its Pennsylvania customers, and since lower cost power is readily available to the Company *if* it were needed.

We express no views on reasonableness of the FERC-approved selling price of Perry 1 power. The equity argument fails as well, because, as the ALJ properly noted "Purely and simply, the incurrence of costs by Penn Power does not result in Penn Power being guaranteed the recovery of those costs through its rates" (R.D. p. 26). We have found that the costs associated with the claimed buy back agreement

should be disallowed as unjust and unreasonable. An "equitable" sharing of the financial burden requires the inclusion of this fact in the equation when assessing the relative burden to be impossed on the Company and its ratepayers.

The Company's last argument, which is that we should allow recovery of this buy back because it is, in Penn Power's share of the cancellation costs imposed upon it when it sold its portion of Perry 1, is legally defective. Cancellation costs should not be collected through the ECR, which is designed to reflect only the actual costs of the purchase or generation of power. 66 Pa. C.S. § 1307. In fact, *any* recovery of cancelled plant expenses from ratepayers is illegal. 66 Pa. C.S. § 1315, *Barasch v. Pennsylvania Pub. Utility Commission*, —— Pa. ——, 532 A.2d 325 (1987).

The Office of Trial Staff ("OTS") contended, in its exceptions, that Penn Power is in an excess capacity position in its base rate case and that it should not be permitted to recover the average system costs of a 12 MW purchase, in lieu of the 12 MW Perry buy back. In our concurrent Opinion and Order in Docket No. R-870732, we do not make an excess capacity adjustment for Penn Power. We, therefore, deny OTS' exception on this point.

The OCA noted that the Perry 1 buy back means that Penn Power is paying $1 million per month for about $100,000 worth of energy. The OCA excepted to the ALJ's recommendation that the high price of Perry 1 buy back energy be used to determine average system cost for the equivalent amount of energy. The OCA also excepted to the ALJ's conclusion that Penn Power does not have excess capacity. For the reasons

expressed in our Opinion and Order in Docket No. R-870732, we shall deny the OCA's exception to the ALJ's excess capacity recommendation. However, we concur with the OCA and the OTS that it is unreasonable to allow the Company to include Perry 1 buy back power in its average system costs, for purposes of calculating an equivalent amount of energy costs to be recovered through the ECR. For this reason, we shall direct the Company to delete the Perry 1 buy back costs from its average system costs calculation.[1] To this extent we grant the OTS' and the OCA's exceptions on this issue.

b. Guidelines for Future Buy/Sell Agreements

The OCA proposed a set of guidelines to be used by the Company in evaluating or drafting future buy/sell agreements. The guidelines incorporate certain least cost planning principles which compare Ohio Edison ("OE") system sales/purchases with other suppliers/buyers of power.

The Company responded that the OCA had failed to account for the fact that OE and Penn Power comprise two parts of a fully integrated, jointly planned and dispatched system. The ALJ recommended that the OCA's proposed guidelines not be adopted in this proceeding because, in general, the current arrangement has worked well and has benefited Penn Power's ratepayers.

The OCA excepted to the recommended decision and argued that Penn Power has not explained why the goal of capacity sharing can only be achieved by reallocating the Ohio Edison System's newest and

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[1] Expressed as FE/SE = average cost of all system energy.

most expensive plants, without regard to the actual need or cost for that power. The OCA requested us to order Penn Power to attempt to negotiate an agreement consistent with the least cost planning guidelines proposed by its witness.

The Company replied to the OCA's exceptions by noting that current affiliated interest agreements are consistent with least cost planning principles and have provided substantial long term benefits to Penn Power and are expected to do so for the foreseeable future. Penn Power stated that all generating units constructed pursuant to the joint planning program are eligible for reallocation, not just the newest ones. The Company emphasizes that Penn Power and Ohio Edison are simply constituent parts of a fully integrated, jointly planned and dispatchable system.

We are persuaded that this record demonstrates that the current arrangement has provided substantial benefits to Penn Power's ratepayers. We shall, therefore, deny the OCA's exception on this issue.

c. ECR Treatment of Capacity Charge Credits

The Company proposed to account for the effects of all future buy/sell agreements solely in the ECR. The ALJ recommended that such an arrangement is more efficient than waiting for the next base rate case and that an expedient investigation can serve to expeditiously provide an appropriate record.

The OTS excepted to the ALJ's recommendation on the ground that anything other than a base rate proceeding is an inadequate forum for the determination of excess capacity issues. The OTS further contended that Penn Power's buy/sell agreements have a direct effect on its overall capacity situation.

The Company responded to the OTS' exception by stating that past ECR investigations have extensively reviewed various utility actions and thus could encompass capacity credit investigations, if appropriate. Penn Power noted that since ECR proceedings occur annually they will constitute a more timely and frequent forum to evaluate the Company's capacity situation than base rate cases. The Company points to the annual review/true-up ECR mechanism as a benefit to ratepayers because they then will receive the exact amount of capacity credit that may be due.

We are persuaded that the ECR proceedings provide a more efficient forum to evaluate capacity credits associated with purchased power expense and that the true-up mechanism will benefit ratepayers. We, therefore, deny the OTS' exception on this issue and approve the Company's proposal that for this and future buy/sell agreements all capacity charge credits be deleted from base rates and credited to the ECR; THEREFORE,

IT IS ORDERED:

1. That, pursuant to Section 2102 of the Public Utility Code, 66 Pa. C.S.A. § 2102, the affiliated interest agreement under consideration at Docket G-870087, which is a supplement to an existing 1987 agreement between the Pennsylvania Power Company and the Ohio Edison Company, is found to be unreasonable and inconsistent with public policy and is, therefore, disapproved. The Company is thereby permitted to recover only the energy costs associated with this affiliated interest agreement purchase.

2. That pursuant to Section 2102 of the Public Utility Code, 66 Pa. C.S.A. § 2102, the affiliated in-

terest agreement under consideration at Docket G-870088, which is an agreement between Pennsylvania Power Company and the Ohio Edison Company to be in effect during 1988, is found to be reasonable and consistent with public policy and is, therefore, approved.

3. That the recovery of the costs associated with the purchase of 12 Mw of Perry Unit No. 1 capacity from the Cleveland Electric Illuminating Company through Pennsylvania Power Company's energy cost rate is hereby denied as unjust, unreasonable and, therefore, unlawful.

4. That, in lieu of the recovery of the costs associated with the purchase of 12 Mw of Perry Unit No. 1 capacity, the Pennsylvania Power Company is permitted to collect the costs of a like quantity of capacity priced at a Company average cost, the latter deemed to be the Fe/Se factor calculated pursuant to the Company's filed tariffs and filed with its energy costs rate, but calculated exclusive of all amounts associated wtih the Perry Unit I energy and capacity costs and the Mansfield capacity charges.

5. That the Company's proposal to delete capacity charges and credits from base rates and flow them through the ECR account be, and hereby is, approved.

6. That Pennsylvania Power Company is hereby directed to file tariff(s) or tariff supplement(s) containing rates, provisions, rules and regulations consistent with our findings herein.

7. That the Pennsylvania Power Company shall comply with all other directives contained in this Opinion and Order, which are not the subject of an individual directive in the preceding ordering para-

graphs, as fully as if they were the subject of a specific ordering paragraph.

8. That, except to the extent granted herein, specifically or by implication, the exceptions of all parties to the Recommended Decision of the Administrative Law Judge be, and hereby are, denied.

9. That upon Commission acceptance and approval of the tariff(s) or tariff supplement(s), directed to be filed herein, the Commission proceedings at Docket No. G-870087, G-870088, M-870111, and R-870732 be terminated and the files marked closed.

APPENDIX D

EXCERPT FROM THE UNITED STATES CONSTITUTION

The Supremacy Clause (art. VI, cl. 2):

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

EXCERPTS FROM THE FEDERAL POWER ACT, 16 U.S.C. §§ 791a-828c

§ 824. Declaration of policy; application of subchapter

(a) Federal regulation of transmission and sale of electric energy

It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this subchapter and subchapter III of this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

(b) Use or sale of electric energy in interstate commerce

(1) The provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but except as provided in paragraph (2) shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over facilities used for

the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

* * * *

(c) Electric energy in interstate commerce

For the purpose of this subchapter, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States.

(d) "Sale of electric energy at wholesale" defined

The term "sale of electric energy at wholesale" when used in this subchapter, means a sale of electric energy to any person for resale.

§ 824d. Rates and charges; schedules; suspension of new rates; automatic adjustment clauses

(a) Just and reasonable rates

All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) Preference or advantage unlawful

No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Com-

mission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Schedules

Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Notice required for rate changes

Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time

when they shall take effect and the manner in which they shall be filed and published.

(e) Suspension of new rates; hearings; five month period

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by fur-

ther order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and resonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(f) Review of automatic adjustment clauses and public utility practices; action by Commission; definition

(1) Not later than 2 years after November 9, 1978 and not less often than every 4 years thereafter, the Commission shall make a thorough review of automatic adjustment clauses in public utility rate schedules to examine—

(A) whether or not each such clause effectively provides incentives for efficient use of resources (including economical purchase and use of fuel and electric energy), and

(B) whether any such clause reflects any costs other than costs which are—

(i) subject to periodic fluctuations and

(ii) not susceptible to precise determinations in rate cases prior to the time such costs are incurred.

Such review may take place in individual rate proceedings or in generic or other separate proceedings applicable to one or more utilities.

(2) Not less frequently than every 2 years, in rate proceedings or in generic or other separate proceedings, the Commission shall review, with respect to each public utility, practices under any automatic adjustment clauses of such utility to insure efficient use of resources (including economical purchase and use of fuel and electric energy) under such clauses.

(3) The Commission may, on its own motion or upon complaint, after an opportunity for an evidentiary hearing, order a public utility to—

(A) modify the terms and provisions of any automatic adjustment clause, or

(B) cease any practice in connection with the clause,

if such clause or practice does not result in the economical purchase and use of fuel, electric energy, or other items, the cost of which is included in any rate schedule under an automatic adjustment clause.

(4) As used in this subsection, the term "automatic adjustment clause" means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include any rate which takes effect subject to refund and subject to a later determination of the appropriate amount of such rate.

§ 824e. Power of Commission to fix rates and charges; determination of cost of production or transmission

(a) Unjust or preferential rates, etc.; statement of reasons for changes; hearing; specification of issues

Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section shall state the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.

(b) Refund effective date; preferential proceedings; statement of reasons for delay; burden of proof; scope of refund order; refund orders in cases of dilatory behavior; interest

Whenever the Commission institutes a proceeding under this section, the Commission shall establish a

refund effective date. In the case of a proceeding instituted on complaint, the refund effective date shall not be earlier than the date 60 days after the filing of such complaint nor later than 5 months after the expiration of such 60-day period. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date 60 days after the publication by the Commission of notice of its intention to initiate such proceeding nor later than 5 months after the expiration of such 60-day period. Upon institution of a proceeding under this section, the Commission shall give to the decision of such proceeding the same preference as provided under section 824d of this title and otherwise act as speedily as possible. If no final decision is rendered by the refund effective date or by the conclusion of the 180-day period commencing upon initiation of a proceeding pursuant to this section, whichever is earlier, the Commission shall state the reasons why it has failed to do so and shall state its best estimate as to when it reasonably expects to make such decision. In any proceeding under this section, the burden of proof to show that any rate, charge, classification, rule, regulation, practice, or contract is unjust, unreasonable, unduly discriminatory, or preferential shall be upon the Commission or the complainant. At the conclusion of any proceeding under this section, the Commission may order the public utility to make refunds of any amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force:

Provided, That if the proceeding is not concluded within fifteen months after the refund effective date and if the Commission determines at the conclusion of the proceeding that the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility, the Commission may order refunds of any or all amounts paid for the period subsequent to the refund effective date and prior to the conclusion of the proceeding. The refunds shall be made, with interest, to those persons who have paid those rates or charges which are the subject of the proceeding.

(c) Refund considerations; shifting costs; reduction in revenues; "electric utility companies" and "registered holding company" defined

Notwithstanding subsection (b) of this section, in a proceeding commenced under this section involving two or more electric utility companies of a registered holding company, refunds which might otherwise be payable under subsection (b) of this section shall not be ordered to the extent that such refunds would result from any portion of a Commission order that (1) requires a decrease in system production or transmission costs to be paid by one or more of such electric companies; and (2) is based upon a determination that the amount of such decrease should be paid through an increase in the costs to be paid by other electric utility companies of such registered holding company: *Provided*, That refunds, in whole or in part, may be ordered by the Commission if it determines that the registered holding company would not experience any reduction in revenues which results from an inability of an electric utility company of the holding company to recover such increase in costs for the period between the refund effective date and

the effective date of the Commission's order. For purposes of this subsection, the terms "electric utility companies" and "registered holding company" shall have the same meanings as provided in the Public Utility Holding Company Act of 1935, as amended [15 U.S.C.A. § 79 et seq.].

(d) Investigation of costs

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

§ 825e. Complaints

Any person, State, municipality, or State commission complaining of anything done or omitted to be done by any licensee or public utility in contravention of the provisions of this chapter may apply to the Commission by petition which shall briefly state the facts, whereupon a statement of the complaint thus made shall be forwarded by the Commission to such licensee or public utility, who shall be called upon to satisfy the complaint or to answer the same in writing within a reasonable time to be specified by the Commission. If such licensee or public utility shall not satisfy the complaint within the time specified or there shall appear to be any reasonable ground for investigating such complaint, it shall be the duty of the Commission to investigate the matters complained of in such manner and by such means as it shall find proper.

APPENDIX E

COMMISSION OPINIONS, ORDERS AND NOTICES

CLEVELAND ELECTRIC ILLUMINATING COMPANY,
DUQUESNE LIGHT COMPANY,
OHIO EDISON COMPANY,
PENNSYLVANIA POWER COMPANY, and
TOLEDO EDISON COMPANY

Docket No. ER88-123-000

Order Accepting and Suspending Rates, Granting Waiver and Establishing Hearing Procedures

(Issued July 29, 1988)

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon and Charles A. Trabandt.

On May 31, 1988, Cleveland Electric Illuminating Company (Cleveland), on behalf of itself and the other members of the Central Area Power Coordinating Group (Central Group),[1] completed the filing of supplements to the Central Group's Basic Operating Agreement (Central Agreement).[2] Under the

[1] Central Group members include the Cleveland Electric Illuminating Company, Duquesne Light Company, Ohio Edison Company, Pennsylvania Power Company, and Toledo Edison Company.

[2] The supplements were originally submitted on December 2, 1987. By letter dated January 20, 1988, Cleveland was informed that the filing was deficient. The company amended its filing on February 19, 1988. By letter dated April 15, 1988, Cleveland was informed that its filing remained deficient.

Central Agreement, unit power and energy is available to a Central Group member from certain designated base load Central Group generating units, including the jointly owned Perry Plant Nuclear Unit No. 1 (Perry unit). The supplements set forth in the specific charges for the sale of capacity and energy by and between Central Group members for the Perry unit.

Charges for the proposed service consist of comprehensive formula rates in which purchasing Central Group members are assessed their pro rata share of the fixed and variable costs of the unit. All Central Group members are joint owners of the Perry unit. While any of the owners could conceivably sell from their owner ship [sic] entitlements, Cleveland is expected to be the only seller. At present, Cleveland is selling 80 MW of its 375 MW entitlement to Ohio Edison Company (Edison). No other sales are currently anticipated.

Cleveland requests waiver of the notice requirements to permit the filing to become effective November 18, 1987, the date that sales commenced to Edison.[3]

Notice of the completed filing was published in the Federal Register with comments, pro tests or interventions due on or before June 27, 1988.[4] No comments, protests, or interventions were filed.

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[3] Rate Schedule Designations

Docket No. ER88-123-000

Description: Appendix No. 7 to Central Group Basic Operating Agreement

The Cleveland Electric Illuminating Company

[4] 53 Fed. Reg. 22,557 (1988).

Discussion

The proposed formula rate components and allocation methodology are substantially identical to those currently on file for sales from other Central Group generating units, with one notable difference. Cleveland has introduced in this filing a formula component to reflect its $80.7 million share of the nuclear decommissioning costs of the Perry unit.[5]

Our analysis reveals that Cleveland has used an amortization period of 35 years for the decommissioning charge for the Perry unit. The licensed life of the Perry unit is 40 years. Cleveland's treatment is contrary to Commission precedent. See Maine Yankee Atomic Power Company, 42 FERC ¶ 61,307 (1988), rehearing denied, 43 FERC ¶ 61,453 (1988). It is our practice to use the licensed life of the plant when calculating recovery of decommissioning charges. Id. In addition, Cleveland provided no evidence supporting its use of a 35-year amortization period in its initial submittal. In response to our staff's deficiency letter, Cleveland stated only that the amortization period was consistent with certain depreciation schedules and that the accelerated period compensated for other omissions in the study. This response does not provide an adequate basis to depart from the use of the licensed life of the plant in calculating the decommissioning charge. Accordingly, we will summarily dispose of this issue by requiring a 40-year amortization period for the decommissioning fund. Because the revenue impact of this decision is not substantial, we will not require the company to make a refiling at

[5] The $80.7 million figure represents Cleveland's 31.11% ownership share of the estimated total decommissioning cost of $259 million.

this juncture. Instead, the company will correct this matter at the compliance filing stage of the proceeding.

Our preliminary review of the filing indicates that the proposed rates have not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Therefore, we will accept Cleveland's supplements for filing and suspend them as ordered below.

In West Texas Utilities Co., 18 FERC ¶ 61,189 (1982), we explained that where our preliminary examination indicates that proposed rates may be unjust and unreasonable, but may not be substantially excessive, as defined in West Texas, we would generally impose a nominal suspension. Here, our examination suggests that the rates may not yield substantially excessive revenues. In these circumstances, we believe that a nominal suspension is warranted. Cleveland has asked for waiver of the notice requirements. Because this request is unopposed and because this is a new service and failure to grant waiver would leave no rate in place, we find good cause to waive the notice requirements. We will therefore accept the supplements to the Central Agreement for filing and impose a nominal suspension, to become effective, subject to refund, on November 18, 1987.

The filing submitted here is specific to the 80 MW Cleveland/Edison transaction. Cleveland reports that no other owners anticipate selling Perry unit power. The Central Group companies are advised, however, that additional transactions under the proposed formula rate will require a timely filing, as a change in rates of company specific rate sheets detailing the proposed rate of return on equity and decommissioning costs, together with appropriate cost support.

The Commission orders:

(A) Cleveland's request for waiver of the notice requirements is hereby granted.

(B) Cleveland's use of a 35-year amortization period for recovery of decommissioning charges is hereby summarily denied. Cleveland is directed to reflect a 40-year amortization period in its decommissioning rates when the compliance filing in this proceeding is submitted.

(C) Cleveland's supplements to the Central Agreement are hereby accepted for filing and are suspended, to become effective subject to refund, on November 18, 1987.

(D) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held concerning the justness and reasonableness of Cleveland's proposed rates.

(E) A presiding administrative law judge, to be designated by the Chief Administrative Law Judge, shall convene a conference in this proceeding within approximately fifteen (15) days from the date of this order, in a hearing room of the Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, DC 20426. Such conference shall be held for the purpose of establishing a procedural schedule, including the filing of a case-in-chief by Cleveland. The presiding judge is authorized to establish pro-

cedural dates and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

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[1] Supplement No. 7 to Supplement No. 5 to Rate Schedule FERC No. 15 Duquesne Light Company.

[2] Supplement No. 7 to Supplement No. 5 to Rate Schedule FERC No. 15 Ohio Edison Company.

[3] Supplement No. 7 to Supplement No. 5 to Rate Schedule FERC No. 144 Pennsylvania Power Company.

[4] Supplement No. 7 to Supplement No. 5 to Rate Schedule FERC 35 Toledo Edison Company.

[5] Supplement No. 7 to Supplement No. 5 to Rate Schedule FERC No. 27.

APPENDIX F

No. 90-1156

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1990

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, JOSEPH I. GIARRUSSO, LAMBERT C. BOISSIERE, JR., MICHAEL EARLY, JAMES SINGLETON, DOROTHY MAE TAYLOR, JOHNNY JACKSON, and PEGGY WILSON,

Respondents.

Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

This case presents a recurring question under the Federal Power Act that has been decided in sharp conflict with this Court's prior decisions and with the decisions of the Massachusetts, North Dakota and Minnesota Supreme Courts:

> Whether states or municipalities have jurisdiction, subject only to state substantial evidence requirements, to nullify FERC's wholesale rate decisions by deciding it was "imprudent" for a utility to fail to "minimize its losses" during construction of a wholesale generating facility and by barring recovery of, and thereby "trapping," wholesale costs that FERC found to be "just and reasonable" and ordered the utility to incur?